United States Department of the Interior

BUREAU OF LAND MANAGEMENT
Montana State Office
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Billings, Montana 59107-6800
http://www.mt.blm.gov/

IN REPLY TO

SDR-922-02-03
160 (922.WL)

March 12, 2002

7MM 3238 7010 3108 2139
CERTIFIED MAIL-RETURN RECEIPT REQUESTED

DECISION

Mr. Jerry Croft
Croft Petroleum Company
P.O. Box 397
Cut Bank, MT 59427

SDR No 922-02-03

AFFIRMED

Croft Petroleum Company (Croft) requests a State Director Review (SDR) of the February 11, 2002, decision of the Great Falls Oil and Gas Field Station (GFFS) Supervisor denying a request for the designation of fuel gas being beneficial use gas for Federal and Tribal leases and Communitization Agreements (CAs) in T. 37 N., R. 6 W., Glacier County, Montana. The SDR request was considered timely filed on February 27 in accordance with 43 CFR 3165.3(b) and was assigned number SDR 922-02-03.

BACKGROUND

On December 3, 2001, the GFFS sent a letter (Enclosure 1) to Croft informing them that during production inspections on eight leases/CAs (involving Tribal, Federal, and Fee leases) operated by Croft, it was identified that a portion of the produced gas was being reported on Form MMS-3160 as "Used on or for Benefit of Lease." The letter stated that there is no equipment on these leases or CAs that would use gas. Therefore, Croft was informed that the gas sold section of Form MMS-3160 should portray the same value as the gas produced section, and the "Used on or for Benefit of Lease" section should be zero. The letter stated that these discrepancies began with the 1994 reports and continue to the present except for lease MTM0175A which began production in November 1999 and has shown reporting discrepancies from that time to the present. The letter also included a summary of the volume discrepancies for the periods described above. Croft was instructed to respond to the letter and either agree that the information is correct or to submit documentation to the contrary.

Croft responded with letters dated December 11 and 12, 2001 (Enclosures 2 and 3). Croft explains that all of the wells on these leases/CAs are connected to a gathering system with a central compressor and glycol dehydrator. The fuel gas used to run the compressor and dehydrator is measured at the compressor station and is then proportionately allocated back to each producing well on the gathering system. This is the volume of gas that is reported as "Used on or for Benefit of Lease." The letters also contain the history behind the construction and ownership of the gathering system. The letters also include a copy of a letter from Minerals Management Service (MMS) dated October 7, 1994 (Enclosure 4), which informs Croft of MMS's conclusions specifying how Croft should value the gas, what volume they should pay on, and how to calculate a transportation allowance. The MMS letter states that, with BLM's approval, Croft may reduce the volume of gas measured at the wellhead for royalty purposes for that portion used as fuel for compression. However,

Croft states in their letter that they never did seek BLM approval to use the gas off the lease. Croft is now requesting approval on the method of their gas accounting the way it is currently done.

The GFFS denied Croft's request in a letter dated February 11, 2002 (Enclosure 5). The request was denied because the fuel gas for the off-lease treating and compression station is obtained from the pipeline system downstream of the lease measurement station and off-lease measurement has not been approved. The letter explains that the issue in determining the status of fuel used for the benefit of a lease is whether that production is first "removed or sold." The BLM requires under 43 CFR 3162.7-3 that all production be properly measured prior to its removal from the lease. Since the compressor is located down stream of the approved measurement point, the gas is considered removed or sold and does not qualify as beneficial use gas. The letter also states that since the gathering system connects to Tribal, Federal, State, and fee wells, permission to move the measurement point for the Federal and Tribal wells off-lease would not have been granted. Therefore, Croft's request was denied.

Croft requested an SDR of this decision by letter dated February 25. Croft claims that their procedure as to proper payment of royalty from federal and Tribal oil and gas leases had been approved by MMS in correspondence of 1993 and 1994. This procedure included reducing the MMBTU from each well by the percent used as fuel gas to arrive at a MMBTU (volume) upon which to pay royalty at the well. Croft also states that they believe that the point of sale of the gas under the leases they operate that sell gas into the gathering system is the interconnect with the Montana Power Company system. It is at that point the value is determined, and therefore it is at this point the volume should be determined also.

Croft also states that the GFFS letter makes much about the measurement point, fuel tap location, and whether the production is first removed or sold. Croft states that the delivery/measurement/sales point is 5.3 miles south of the compressor and the fuel gas meter is located in the compressor building. The well spacing is approximately 640 acres per well and no single spacing unit is productive enough to merit its own compressor and pipeline system. Therefore for a common gathering system to site a compressor only one of the multiple wells on the system can actually be physically on the same lease as the compressor.

Croft also states that if they understand GFFS's position, on a 10-well system the well that is located in the same spacing unit as the compressor site could supply 100 percent of the fuel gas for the entire system with no royalty being paid, and the other nine wells would supply none of the fuel gas.

DISCUSSION

Croft claims that their procedure had been approved by MMS in correspondence from 1993 and 1994. It is clear in MMS's letter of October 7, 1994, that Croft needed BLM approval to reduce the volume of gas measured at the wellhead for royalty purposes for that portion used as fuel for compression. Croft acknowledges in their December 11, 2001, letter that they never did seek BLM approval to use the gas off the lease. Therefore, relying on the MMS correspondence as an approval of the measurement procedure is incorrect.

Croft also states that they believe that the point of sale of the gas under the leases they operate that sell gas into the gathering system is the interconnect with the Montana Power Company system. It is at that point the value is determined, and therefore it is at this point the volume should be

determined also. The regulations at 43 CFR 3162.7-3 require that all gas production be measured on the lease, and further state that off-lease measurement or commingling with production from other sources prior to measurement may be approved by the authorized officer. Croft has never requested approval to have the measurement approved at the interconnect with the Montana Power Company. This measurement point would involve commingling of the production from all eight leases/CAs. Since no approval has been granted for commingling and/or off-lease measurement, the approved measurement points are each of the well head meters located on lease/CA. Also, since off lease measurement would involve commingling of production from Federal, Tribal, and Fee wells that have different royalty rates, off lease measurement and commingling would not be approved.

The fact that the GFFS letter discusses the measurement point, fuel tap location, and whether the production is first removed or sold is very relevant. While Croft argues that the delivery/measurement/sales point is 5.3 miles south of the compressor, the regulations, as referenced above, require that all gas production be measured on lease. Once the gas leaves each of the leases/CAs it is commingled with production from the other wells. The gas is determined to have been removed or sold once it passes through the well head meters, and therefore can no longer be considered as being used for beneficial purposes.

Croft's understanding that the well that is located in the same spacing unit as the compressor site could supply 100 percent of the fuel gas for the entire system with no royalty being paid, and the other nine wells would supply none of the fuel gas is incorrect. In this situation, the gas being used for fuel gas would not only be for the benefit of that particular lease, but would also be for the benefit of the other nine wells. Therefore, claiming the fuel gas as beneficial use gas would not be allowed.

DECISION

It is clear that the BLM approval referred to in the MMS correspondence was never requested and therefore never granted. As stated in the regulations, measurement of all gas production must take place on lease. Since any off lease measurement would involve commingling of production from Federal, Tribal, and Fee wells that have different royalty rates, off lease measurement and commingling would not be approved. The gas is determined to have been removed or sold once it passes through the well head meters. It is then commingled with production from the other leases/CAs. Therefore, the gas can no longer be considered as being used for beneficial purposes. Therefore, the decision of the GFFS Supervisor is affirmed. Croft is instructed to no longer report the compressor and fuel gas as used on or for benefit of lease. Also, MMS will be notified of the volume discrepancies identified by the GFFS, and they may require amended reports and payment of royalties on the fuel gas.

APPEAL RIGHTS

This Decision may be appealed to the Board of Land Appeals, Office of the Secretary, in accordance with the regulations contained in 43 CFR 4.400 and Form 1842-1 (Enclosure 6). If an appeal is taken, a Notice of Appeal must be filed in this office at the aforementioned address within 30 days from receipt of this Decision. A copy of the Notice of Appeal and of any statement of reasons, written arguments, or briefs must also be served on the Office of the Solicitor at the address shown on Form 1842-1. It is also requested that a copy of any statement of reasons, written arguments, or briefs be sent to this office. The appellant has the burden of showing that the Decision appealed from is in error.

If you wish to file a Petition for a Stay of this Decision, pursuant to 43 CFR 4.21, the Petition must accompany your Notice of Appeal. A Petition for a Stay is required to show sufficient justification based on the standards listed below. Copies of the Notice of Appeal and Petition for a Stay **must** also be submitted to each party named in the Decision and to the Interior Board of Land Appeals and to the appropriate Office of the Solicitor (see 43 CFR 4.413) at the same time the original documents are filed with this office. If you request a stay, you have the burden of proof to demonstrate that a stay should be granted.

Standards for Obtaining a Stay

Except as otherwise provided by law or other pertinent regulation, a petition for a stay of a Decision pending appeal shall show sufficient justification based on the following standards:

1) The relative harm to the parties if the stay is granted or denied,

The likelihood of the appellant's success on the merits

3 The likelihood of immediate and irreparable harm if the stay is not granted, and

4 Whether the public interest favors granting the stay

/s/ Thomas P. Lonnie

Thomas P. Lonnie
Deputy State Director
Division of Resources

4 Enclosures
1-GFFS letter of December 3 (2 pp)
2-Croft letter of December 11 (3 pp)
3-Croft letter of December 12 (4 pp)
4-MMS letter of October 7, 1994 (5 pp)
5-GFFS letter of February 11, 2002 (2 pp)
6-Form 1842-1 (1 p)

cc:(w/o encls.)
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WO(310), LS, Rm. 406
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